Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Message Text

CONFIDENTIAL

PAGE 01 CAIRO 02376 01 OF 02 202031Z
ACTION NEA-10

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C O N F I D E N T I A L SECTION 01 OF 02 CAIRO 02376

E. O. 11652: GDS
TAGS: EFIN, EGEN, EG
SUBJ: EGYPTIAN ECONOMIC SCENE--ONE YEAR AFTER RIOTS

1. SUMMARY: EGYPT'S EXTERNAL ECONOMIC OUTLOOK FOR 1978 CONTRASTS SHARPLY WITH BLEAK PICTURE AT BEGINNING OF 1977. LIQUIDITY CRISIS OF SUBSTANTIAL MAGNITUDE OBTAINED THEN, AS ARREARS IN PAYMENTS TO FOREIGN BANKS AND SUPPLIERS INCREASED DAILY. AUSTERITY BUDGETARY MOVE TO RECONCILE INTERNAL ECONOMIC DISTORTIONS HAD COLLAPSED IN WAKE OF MASS DEMONSTRATIONS. AT THIS JUNCTURE, ONE YEAR LATER, GOE IS ON MUCH FIRMER INTERNATIONAL FINANCIAL FOOTING, AND THERE IS PROBABILITY THAT FURTHER CAREFUL MANAGEMENT OF FOREIGN EXCHANGE RESOURCES WILL PERMIT CONTINUATION OF IMPROVED SITUATION. POTENTIALLY CONTROVERSIAL DOMESTIC REFORMS, HOWEVER, HAVE NOT BEEN UNDERTAKEN AND AVERAGE EGYPTIAN FACES SEVERE ECONOMIC PROBLEMS. END SUMMARY

2. RECENT EMBOFF DISCUSSION WITH MINECON UNDERSECRETARY FOR FOREIGN EXCHANGE OPERATIONS, AHMED EL BANNA, SERVES CONFIDENTIAL

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PAGE 02 CAIRO 02376 01 OF 02 202031Z

AT THIS TIME, ONE YEAR AFTER JANUARY RIOTS, TO COMPARE PRESENT GOE POSITION WITH THAT AT BEGINNING OF 1977. MOST DRAMATIC REVERSAL HAS OCCURRED ON FOREIGN EXCHANGE FINANCING FRONT. IN JANUARY 1977, GOE FACED, ACCORDING EL BANNA, LE 400 MILLION EQUIVALENT IN ARREARS, LARGE PORTION OF WHICH WAS 150 DAYS OVERDUE. EGYPT HAD NO RESERVES TO OFFSET THESE ARREARS OR COVER COST OF

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

VITAL FOOD AND CAPITAL INPUTS FOR 1977. COMMERCIAL BANKS AND SUPPLIERS, ALREADY DISTURBED BY DELINQUENT ACCOUNTS, WERE RELUCTANT TO UNDERWRITE NEW PURCHASES WITHOUT HIGH INTEREST AND CARRYING CHARGES PLUS GUARANTEES OF PRIORITY REPAYMENT FROM GOE CENTRAL BANK. NO CREDITORS WERE ACTIVELY SEEKING NEW BUSINESS.

3. DUE TO CAREFUL (SKILLED, IN WORD OF IBRD OFFICIAL) MANAGEMENT OF EMERGENCY ASSISTANCE FROM GODE, U. S. AND OTHERS DURING EARLY 1977, GOE ECONOMIC GROUP LED BY DEP-PRIMIN ABDEL MONEIM KAISSOUNI CLEARED UP ALL OUTSTANDING ARREARS BY END AUGUST 1977. IN LAST QUARTER OF YEAR, WITH INFLOW OF GODE SECOND TRANCHE, GOE OPERATED ON STRICTLY CASH BASIS. EL BANNA, WHO ASSERTED HE SERVES AS OPERATIVE CONTROL FOR CENTRAL BANK PAYMENTS, INDICATED THAT GOE EXPECTS TO CONTINUE CASH OPERATION THROUGH JUNE 1978. AT THAT POINT, GOVERNMENT WOULD NEED SOME ADDITIONAL ASSIS-TANCE TO SUSTAIN NORMAL IMPORT LEVELS IN KEY COMMODITIES. EL BANNA DOES NOT FORESEE PROBLEMS NOW, AS PLANNED U. S. PL 480 AND CIP ASSISTANCE SHOULD CONTRIBUTE SIGNIFICANTLY TO COVERAGE OF FOOD IMPORTS (E.G., WHEAT), PLUS REQUISITE INTERMEDIATE AND CAPITAL GOODS DURING FIRST HALF OF YEAR. NONETHELESS, HE STRESSED THAT INCREASED LEVELS OF AID ARE NECESSARY, NOTING THAT MINECON AND MINFIN OFFICIALS ARE PREPARING DETAILS TO SUBSTANTIATE REQUEST FOR SUPPLE-MENTAL ASSISTANCE AT DIRECTION OF DEPPRIMIN KAISSOUNI. CONFIDENTIAL

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PAGE 03 CAIRO 02376 01 OF 02 202031Z

EL BANNA SAID EGYPT HOPES TO USE NO MORE THAN $500 - $600 MILLION IN SHORT-TERM BANK FACILITIES DURING 1978. GOE OFFICIALS BELIEVE EVEN THIS FIGURE COULD BE SHAVED WITH CAUTIOUS IMPORT MANAGEMENT AND BETTER UTILIZATION OF AVAILABLE PROJECT PIPELINE TO COVER CAPITAL IMPORTS. GIVEN BETTER REPAYMENT CAPABILITY, NEITHER EL BANNA NOR LOCAL BANKING SOURCES RULE OUT POSSIBILITY OF DIRECT EGYPTIAN DEMARCHE TO EUROMARKET FOR BOP SUPPORT AT SOME TIME IN NEXT 12 - 18 MONTHS.

4. MINECON OFFICIAL POINTED OUT TO EMBOFF THAT 1977 HAD SEEN INCREASED COORDINATION AMONG ECONOMIC MINISTRIES AND LONG-AWAITED FIVE-YEAR PLAN HAD BEEN COMPLETED AND APPROVED BY PEOPLES ASSEMBLY. (NOTE: OUR UNDERSTANDING IS THAT ONLY 1978 PLAN WAS ACTUALLY APPROVED IN CONTEXT OF 1978 BUDGET AND TOTAL FIVE-YEAR PACKAGE STILL UNDER REVIEW.) THIS GIVES ADMINISTRATION GUIDE TO FOLLOW IN DEVELOPMENT/INVESTMENT PROGRAM AND GOVERNMENT HOPES TO ADHERE CLOSELY TO SCHEME. DURING FIRST YEAR, EL BANNA SAID, ECONOMIC OFFCIALS CAN MODIFY PROGRAM IN LINE WITH AVAILABLE RESOURCES, IF INITIAL EXPENDITURE ESTIMATES ARE TOO LARGE AS SOME FOREIGN OBSERVERS HAVE SUGGESTED. HE

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

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TOOK CURRENT CONFIDENT NOTE, VOICED ELSEWHERE IN GOE,
THAT ADMINISTRATION WILL NOT FALL SHORT OF STATED INVEST-
MENT GOALS. HE PERCEIVES GOE FOREIGN EXCHANGE POSITION
AS STRONGER THAN ANY TIME IN PAST DECADE AND BELIEVES THIS
WILL BE SIGNIFICANT IN IMPROVING OVERALL ECONOMIC
PICTURE.
5. EL BANNA OPENLY ADMITS GOE EXPECTATION THAT FOREIGN
PRIVATE INVESTMENT WILL BE CRITICAL STIMULUS TO PRIVATE
SECTOR GROWTH. GOVERNMENT, ACCORDING SOURCE, MUST DEVOTE
ITS INVESTMENT ACTIVITIES OVER LENGTH OF FIVE YEAR PLAN TO
UPGRADING DILAPIDATED INFRASTRUCTURE. WHILE CONCEDING GOE
ACTUALLY PLANS TO DECREASE AMOUNT OF GOVERNMENT RESOURCES
DIRECTLY AVAILABLE TO PRIVATE ENTREPENEURS, HE MAINTAINS
INFRASTRUCTURE IMPROVEMENT WILL BE CRUCIAL FACTOR IN
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PAGE 04 CAIRO 02376 01 OF 02 202031Z

CONFIDENTIAL

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CONFIDENTIAL

PAGE 01 CAIRO 02376 02 OF 02 202036Z
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INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
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C O N F I D E N T I A L SECTION 02 OF 02 CAIRO 02376

STIMULATING FOREIGN INVESTMENT HERE. HE FURTHER REMARKED
THAT CONTINUAL REASSESSMENT OF INVESTMENT PLAN WOULD
ENABLE GOE TO SHIFT RESOURCES TO PRIVATE SECTOR IN EVENT
OF SERIOUS STAGNATION.

6. REFORMS ACCOMPLISHED DURING 1977, IN EL BANNA'S VIEW,

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

WERE AIMED AT IMPROVING EGYPT'S EXTERNAL FINANCIAL RELATIONS. THIS SUCCESS HAS BEEN MOST RECENTLY EVIDENCED BY DECLINE IN SHORT-TERM INTEREST RATES FROM 17 PERCENT TO 7 PERCENT, FIGURE ALSO CITED RECENTLY IN PRESS BY DR. KAISSOUNI. EGYPT, ACCORDING MINECON REP, HAD TO RE-ESTABLISH FINANCIAL CREDIBILITY WITH INTERNATIONAL BANKING COMMUNITY. NOW THAT THIS HAS BEEN ACHIEVED, MINECON/MIN-FIN HOPE TO MAINTAIN SITUATION BECAUSE EGYPT'S IMPORT DEMAND IS HIGHLY INELASTIC, PARTICULARLY IN FOOD COMPONENT. AS RESULT FINANCING MUST BE CONSISTENTLY AVAILABLE.

7. INTERNAL REFORMS, AS EL BANNA SEES IT, ARE FOR A FUTURE, MORE STABLE TIME. SUBSIDIES ARE VITAL TO WELFARE OF PEOPLE AND PRESENT ADMINISTRATION IS COMMITTED TO CONFIDENTIAL

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PAGE 02 CAIRO 02376 02 OF 02 202036Z

CONTINUING THEM --EVEN AT EXPENSE OF DEVELOPMENT, SHOULD IT COME TO THAT.

8. COMMENT: WE SEE ABOVE ASSESSMENT AS TIMELY AND PERTINENT TO PREVAILING EGYPTIAN ECONOMIC CONDITIONS: EXTERNAL PICTURE APPEARS AT LEAST TEMPORARILY BETTER, ASSUMING GOE CAN MAINTAIN SAME DEGREE OF CONTROL EXHIBITED DURING 1977. (LONGER-TERM BALANCE OF PAYMENTS PICTURE REMAINS CLOUDY AND WILL CONTINUE TO DEPEND HEAVILY ON EXTERNAL ASSISTANCE.) IN CONTRAST, INTERNAL PROBLEMS ABOUND. ALTHOUGH GOE'S CURRENT INTERNATIONAL FINANCIAL CREDIBILITY HAS BEEN ENHANCED, AVERAGE EGYPTIAN MAY WELL BE WORSE OFF IN JANUARY 1978 THAN HE WAS AT TIME OF 1977'S MASSIVE DEMONSTRATIONS. FOOD PRICES ARE RISING DESPITE SIZEABLE GOE BUDGETARY SUPPORT OF SUBSIDIZED COMMODITIES. WAGE INCREASES HAVE NOT KEPT PACE, EVEN WITH OFFICIAL PUBLISHED FIGURE OF 14 PERCENT PER ANNUM (INFORMED OBSERVERS AGREE INFLATION ATTAINED AT LEAST 20 PERCENT LEVEL LAST YEAR). CONTROLLED RENTS CONTRIBUTE TO HOUSING SHORTAGE AS INVESTORS AVOID LOW-COST SUBSIZED PROJECTS THAT WOULD MEET MASS NEEDS IN FAVOR OF POTENTIAL INCOME EARNERS SUCH AS LUXURY APARTMENTS AND OFFICE COMPLEXES.

9. TO A DEGREE, PRICE INCREASES ARE INEVITABLE AS RESULT OF GOE PROGRAMS UNDERTAKEN TO IMPROVE INTERNATIONAL FINANCIAL SITUATION AND DECISION TO MEET, TO EXTENT POS-SIBLE, VARIOUS FINANCIAL CEILINGS REQUIRED BY IMF ON DOMESTIC SIDE. THUS, WHILE EGYPT'S IMPROVED INTERNATIONAL FINANCIAL OUTLOOK OFFERS WELCOME CONTRAST WITH CURRENT DOMESTIC PROBLEMS, QUESTION REMAINS WHETHER GOE CAN MAIN-TAIN IMPROVED EXTERNAL FINANCIAL SITUATION THROUGHOUT 1978. EILTS

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

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